

VZCZCXRO7155
PP RUEHDBU RUEHLN RUEHPOD RUEHVK RUEHYG
DE RUEHMO #2472/01 1451719
ZNR UUUUU ZZH
P 251719Z MAY 07
FM AMEMBASSY MOSCOW
TO RUEHC/SECSTATE WASHDC PRIORITY 0642
INFO RUEHIT/AMCONSUL ISTANBUL PRIORITY 0681
RUCNCIS/CIS COLLECTIVE
RUEHXL/MOSCOW POLITICAL COLLECTIVE
RUEHLN/AMCONSUL ST PETERSBURG 4140
RUEHVK/AMCONSUL VLADIVOSTOK 2141
RUEHYG/AMCONSUL YEKATERINBURG 2456

UNCLAS SECTION 01 OF 04 MOSCOW 002472

SIPDIS

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: [PREL](#) [PGOV](#) [ECON](#) [PARM](#) [ENRG](#) [RS](#)
SUBJECT: CODEL NELSON/LOTT: SCENESETTER

MOSCOW 00002472 001.2 OF 004

¶1. (SBU) Your visit comes at a vital juncture in Russian-American relations. As Russia moves closer to succession in March 2008, the more complicated this relationship will be to manage. There is a lot at stake: deepening cooperation in reversing North Korea's nuclear status and preventing the emergence of Iran as a nuclear power; building US-Russian leadership in the promotion of civilian nuclear energy and non-proliferation and energy security for producer and consumers alike; fighting terrorists and the ideology that motivates them; reinforcing promising trends like the growth of a middle class; and encouraging the development of civil society and democratic institutions, despite worrisome trends. While differences over missile defense, Kosovo and Russia's treatment of its neighbors are real, high-level engagement is essential to advance our interests in areas of strategic importance.

¶2. (SBU) Your visit follows on the recent consultations by Secretary Gates and Secretary Rice and will be followed by a

SIPDIS
meeting of Presidents Bush and Putin on the margins of the June 6 G8 summit in Potsdam. Contacts between parliamentarians constitute an important channel of bilateral communication. Congressman Lantos was here in February and is scheduled to hold a bilateral session with counterparts from the Duma in Washington in June. Senator Lugar and former Senator Nunn are expected to travel to Russia in late August to commemorate the 15th anniversary of the Nunn-Lugar program. Your interparliamentary dialogue with the Federation Council and your meetings with Russian leaders will serve to underline that commitment to engagement.

Russia is Back

¶3. (SBU) Buoyed by high energy prices and eight years of economic growth, the Russian elite sees a self-assured and economically dynamic Russia reassuming its place on the world stage. The Russians view the world as full of possibilities -- the U.S. is focused on Iraq and Afghanistan; Europe is consumed with leadership transitions; and the Middle East offers opportunities to renew old ties while building new ties to countries like Saudi Arabia. From the Kremlin's perspective, Russia's own neighborhood looks a lot better than it did a year ago, with NATO expansion less imminent and Ukraine's orange revolution fading. Georgia's interest in NATO and insistence on restoring sovereignty over Abkhazia and South Ossetia, however, remain an issue for the Russians.

Political Landscape

¶4. (SBU) Despite Russia's resurgence, the elite here maintains its peculiar mix of insecurity and cockiness. Duma elections in December and the presidential succession are less than one year away. While Putin's popularity hovers near 80%, authorities have hindered demonstrations by the opposition organization "Other Russia" in cities throughout Russia. A series of election-related legislation has eliminated independent candidates and raised the bar to Duma representation from five to seven percent of the popular vote. Still, it appears that at least four, and possibly five, parties will be represented in the next Duma. A recently-created party, "For A Just Russia," although initially a brainchild of the Kremlin, shows signs of becoming a genuine political force.

¶5. (SBU) Looming larger than the Duma election contest is the 2008 presidential succession. First Deputy Prime Ministers Sergey Ivanov and Dmitriy Medvedev are the front runners, but Putin has yet to indicate a preference and, in the interest of avoiding lame duck status, may not do so until after the December Duma elections.

Economic Prospects

¶6. (U) The Russian economy has been growing steadily since the 1998 financial crisis, with annual GDP growth averaging 7%. Russia has an impressive fiscal surplus that reached 7.4% of GDP in 2006, bolstered by high global prices for its oil, natural gas, and metals exports. To help protect against a sharp drop in energy prices, Russia has accumulated a \$113 billion Stabilization Fund. Russia's foreign debt is 5.1% of GDP, down from 75.7% of GDP in 1999. Reserves have topped \$380 billion.

MOSCOW 00002472 002.2 OF 004

¶7. (SBU) The EU represents Russia's largest trading partner, driven largely by Europe's dependence on Russian oil and natural gas, but also by Russia's booming demand for European machinery and consumer goods. Russia also maintains significant trade with China. Although still a relatively small percentage of Russia's total, trade with the U.S. grew by 20 percent last year, and investment was up more than 50 percent. Some notable recent successes include Amway, whose sales reached \$250 million after only two years here; Alcoa, with over \$300 million invested in two aluminum fabricating facilities; International Paper, which is investing an additional \$400 million here in a 50/50 joint venture with Ilim Pulp; and Ford, with over \$500 million already in its St. Petersburg auto plant. U.S. finance and service companies are also investing here, including Citibank, the largest foreign bank in Russia, with 38 branches servicing over 400,000 clients.

¶8. (SBU) World Trade Organization. There are few events more likely to help our exporters than getting Russia into the WTO on terms we can live with. The Russian Government is pushing hard to complete its decade-long WTO accession process, but significant issues remain. Russia must complete multilateral negotiations, and fulfill its bilateral obligations to the U.S., spelled out in our November, 2006, market access agreement, including better IPR protection and market access for U.S. agricultural products. You will meet with Economic Development and Trade Minister Gref, a strong proponent of free trade, who shares Putin's resolve to decide the issue during his tenure. Gref will likely raise the constraints of the Jackson-Vanik Amendment.

¶9. (SBU) Trade and Investment Challenges. Investors in Russia have long requested clear guidelines on the sectors in which they can invest. A draft Law on Foreign Investment in

Strategic Sectors is now moving through the legislative process, and should help improve the situation. The same is true for long-awaited amendments to Russia's Subsoil Law, which will clarify which energy deposits foreigners may own. The subsoil restrictions would align legislation with the current practice of prohibiting foreign firms from holding majority stakes in projects with fields over 510 million barrels of oil or 50 billion cubic meters of gas.

¶10. (SBU) Promising Sectors. Despite increased Russian Government control over the energy sector, Chevron and Gazprom Neft have formed a joint venture to work in West Siberia; Lukoil and ConocoPhillips continue to expand their partnership; and energy service companies are doing very well. Gazprom CEO Alexey Miller, whom you will meet, is a longtime confidante of President Putin, having worked for him in St. Petersburg. In the aircraft manufacturing and sales sector, Russia is working to revive its own manufacturing capabilities, but is also looking to update its aging fleets. Boeing has been working hard over the past two years to win a share of that market.

Emerging Middle Class

¶11. (SBU) The emerging middle class is becoming one of the most important trends in Russia today. Real incomes have gone up 70 percent in seven years. The average Russian earns an annual salary of an estimated \$4570, with Moscow's 15 million inhabitants earning roughly twice that figure. And at least another third of wages are "grey" - unreported and untaxed. Most experts place the upper class at one percent of the population, the middle class - 20 percent, the lower-middle class - 65-70 percent, and 10-15 percent live in poverty. The emerging middle class eventually will likely want a voice and vote in how their country is governed and how their tax dollars are spent.

Energy Security

¶12. (SBU) Russia faces two broad challenges: getting its hydrocarbons out of the ground, and delivering them to the market. For this, the Russian energy sector will need billions of dollars in investment. Russia has capital and know-how, but will need additional foreign capital and specialized know-how. The ability of Russia to attract and hold investors will depend greatly on the GOR's steps toward rule of law, transparency and good corporate governance.

MOSCOW 00002472 003.2 OF 004

¶13. (SBU) We are involved in discussions with Russia on energy security issues both bilaterally through an energy dialogue and through the G-8. Our messages are that Russia, the world's largest producer of hydrocarbons, has an obligation to provide reasonable leadership on key components of global energy security, including predictable, pro-market regulatory and tax regimes and diversification of sources and transit routes. Key energy security issues such as these were agreed by Russia and other G-8 leaders in last year's St. Petersburg Plan of Action.

Nuclear Cooperation

¶14. (SBU) You will have a meeting with Rosatom Director Sergey Kiriyenko. Much progress has been made on U.S.-Russian nuclear energy cooperation over the past year. The U.S. and Russia have formed a Civil Nuclear Energy Working Group to help align our respective nuclear energy proposals. Negotiations on a 123 Agreement are ongoing and, to date, have been fruitful and the U.S. Russia Global Initiative to Combat Nuclear Terrorism, launched at the G8 in 2006, has grown to 30 countries.

¶15. (SBU) U.S.-Russian cooperation on nuclear nonproliferation remains robust, with work proceeding well to meet the aggressive schedules for completing nuclear security work outlined in the Bratislava Presidential initiative. The Nunn-Lugar program will celebrate its 15th anniversary this year. Under the Elimination of Weapons Grade Plutonium Production program, DOE and Rosatom are moving closer to the goal of shutting down two plutonium production reactors in ¶2008. With respect to the Plutonium Disposition program, Russia has recently expressed a plan that it feels is financially and technically credible and discussions with Washington are ongoing. On the heels of the 2006 signing of the protocol on liability and the reaffirmation of commitment to the program by Director Kiriyenko, there is reason for cautious optimism for a mutually acceptable program.

Security and Nonproliferation Issues

¶16. (SBU) Missile Defense. Russia's opposition to the planned deployment of U.S. missile defense assets in the Czech Republic and Poland has been intense - and highly public. The Russians reject our analysis of the future Iranian threat, believing the placement of interceptors and radars in Poland and the Czech Republic is provocative, and distrust our long-term intentions. Secretary Gates has proposed cooperation, there will be an experts meeting in June, and Secretaries Gates and Rice will meet their counterparts in the fall to continue high level discussions.

¶17. (SBU) Conventional Forces in Europe (CFE) Treaty. In his April 26 State of the Federation address, Putin declared that a "moratorium" on Russian compliance with CFE would be necessary until NATO countries ratify the adapted treaty. Russia rejects NATO members' insistence that Russia first complete its Istanbul Commitments of removing remaining troops from Georgian and Moldovan territory before NATO members ratify the Adapted CFE Treaty. Foreign Minister Lavrov, terming the status quo "absurd," called on May 23 for an extraordinary CFE Conference.

¶18. (SBU) NATO. Russia's neuralgia about the prospect of Ukrainian entry into NATO has eased somewhat as Ukraine struggles with its internal political situation. Russia strongly opposed the establishment of Intensified Dialogue for Georgia. Your visit coincides with the Federation Council's passage of the NATO/PFP-Russia Status of Forces Agreement (SOFA) on May 24, following the Duma approval on May 23. Passage sends a positive message on the 5th Anniversary of the NATO-Russia Council. A SOFA will remove the stumbling block to joint exercises that precipitated the fall 2006 cancellation of the bilateral Torgau military exercise.

¶19. (SBU) Sanctions. The U.S., in July 2006 and again in December, imposed INPA (Iran Nonproliferation Act, now known as the Iran, North Korea, and Syria Nonproliferation Act) sanctions against Rosoboronexport, the Russian government-supported arms agency that oversees all arms exports. The GOR regards the sanctions as an attempt to undercut the Russian arms industry and deprive it of what Russian leaders see as legitimate markets. Your

MOSCOW 00002472 004.2 OF 004

interlocutors will argue that this is an extraterritorial application of U.S. law and their sales do not violate international law or UN sanctions.
BURNS